

**DEPARTMENT OF TAXATION
2009 Fiscal Impact Statement**

1. **Patron** Janet D. Howell

2. **Bill Number** SB 946

House of Origin:

 Introduced

 Substitute

 Engrossed

3. **Committee** House Finance

4. **Title** Minimum Tax; Non-corporate Entities

Second House:

 X **In Committee**

 Substitute

 Enrolled

5. Summary/Purpose:

This bill would continue to subject all telecommunications companies to the greater of either the Corporate Income Tax or a minimum tax. On September 12, 2008, in Virginia Cellular, LLC. V. Virginia Department of Taxation, the Virginia Supreme Court ruled that the Virginia Telecommunications Companies Minimum Tax (the "Minimum Tax") did not apply to non-corporate companies. This decision overturned almost 20 years of administrative precedent subjecting all telecommunications companies to the greater of the corporate income tax or the minimum tax. The bill would also continue to apply the Virginia Minimum Tax on Certain Electric Suppliers to non-corporate entities. Additionally, this bill would clarify that other taxes applicable to corporations may also be applied to non-corporate entities.

The provisions of this bill that clarify that other taxes applicable to corporations may also be applied to non-corporate entities would be declarative of existing law and effective September 1, 2004. The provisions of the bill applying the Virginia Telecommunications Companies Minimum Tax and the Virginia Minimum Tax on Certain Electric Suppliers would be retroactive, effective for taxable years beginning on and after January 1, 2004.

This is a Department of Taxation Bill.

6. **Fiscal Impact Estimates are:** Final. (See Line 8.)

7. **Budget amendment necessary:** No.

8. **Fiscal implications:**

Administrative Costs

As this bill would preserve the status quo, there would be no administrative costs to TAX.

Revenue Impact

Passage of this bill would have no revenue impact, as its enactment would avoid a revenue reduction to the General Fund. Failure to enact this legislation would result in a potential exposure of approximately \$30 million in refund claims from non-corporate telecommunications companies in FY 2009 and FY2010. The Supreme Court of Virginia's ruling would also mean a loss of Minimum Tax revenues from non-corporate entities for tax year 2007, which was due October 15, 2008, and all future years. TAX estimates that without this legislation there would be a revenue loss of \$5-7 million a year of Minimum Tax revenues for FY 2009 and future years in addition to the refund exposure for prior years.

Also, because current telecommunications companies organized as corporations may decide to reorganize as pass-through entities to avoid Minimum Tax liability, the potential loss of Minimum Tax revenues for future years may be significantly greater. Telecommunication companies organized as corporations provided approximately \$19 million in Minimum Tax revenues in tax years 2004 and 2006 and approximately \$14 million in tax year 2005. As telecommunications companies organized as corporations reorganize, the Commonwealth would also lose Corporate Income Tax revenues in future years. The revenue loss from current telecommunications corporations could potentially be up to \$20 million a year.

9. Specific agency or political subdivisions affected:

Department of Taxation
State Corporation Commission

10. Technical amendment necessary: No.

11. Other comments:

Background

Before the 1988 General Assembly session, all telecommunications companies were subject to a 2% gross receipts tax. In 1988 the General Assembly subjected telecommunications companies to the Corporate Income Tax instead of the gross receipts tax. As the revenue from the Corporate Income Tax on telecommunications companies was significantly less than the revenue received from the gross receipts tax, the 1988 General Assembly also subjected telecommunications companies to a minimum tax as well.

Under *Va. Code* § 58.1-400.1, a telecommunications company may be subject to the Minimum Tax instead of the Corporate Income Tax if the Minimum Tax exceeds the Corporate Income Tax.

TAX's regulation regarding the applicability of the Minimum Tax to non-corporate entities, 23 *Virginia Administrative Code* 10-120-89, was published in 1990. The regulation reconciled the statute, which does not exclude non-corporate entities from the definition of "telecommunications companies", with the fact that non-corporate entities are not liable for

the corporate income tax. The regulation provides that, unless specifically exempt from the Minimum Tax, every telecommunications company is subject to the Minimum Tax. This would be true even if the company is exempt from Corporate Income Tax. The regulation also describes how the Minimum Tax is computed and gives non-corporate entities a credit for the corporate income tax it would have paid if it was incorporated. This regulation was promulgated under the Virginia Administrative Process Act and went unchallenged for nearly 20 years.

On September 12, 2008, in Virginia Cellular, LLC. V. Virginia Department of Taxation, the Virginia Supreme Court ruled that the Minimum Tax did not apply to non-corporate companies. The Court ruled that TAX's 20 year old regulation was inconsistent with Va. Code § 58.1-400.1. In so ruling, the Court created a tax loophole that allows telecommunications companies to avoid paying the tax by simply changing their form of business. Under the Court's ruling, telecommunications companies organized as corporations would be subject to tax, while those organized as pass-through entities would pay no tax. Clearly when the law was enacted in 1988, it was not the intent of the General Assembly to allow companies to totally escape taxation by changing their form.

Proposal

This bill would continue to subject all telecommunications companies to the greater of the Corporate Income Tax or the Minimum Tax and overturn Virginia Cellular, LLC. V. Virginia Department of Taxation. The bill would also ensure that the same treatment of non-corporate entities continues to apply to the Virginia Minimum Tax on Certain Electric Suppliers. Additionally, this bill would clarify that this and other taxes may also be applied to non-corporate entities.

The provisions of this bill that clarify that the taxation of pass through entities would be declarative of existing law and effective September 1, 2004. The provisions of the bill applying the Virginia Telecommunications Companies Minimum Tax and the Virginia Minimum Tax on Certain Electric Suppliers would be retroactive, effective for taxable years beginning on and after January 1, 2004.

Similar Legislation

House Bill 2378 is identical to this bill.

cc : Secretary of Finance

Date: 2/6/2009 AM
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